

May 2, 2006

To: Land Board Members cc: End. Fund Inv. Board

From: Reform Review Task Force

Subject: **ASSET MANAGEMENT GUIDELINES OVERVIEW**

Attached for your consideration is the Overview section of an Asset Management Guidelines document. Its purpose is to articulate the high-level principles used in guiding the management of the land and funds that have been entrusted to the state for endowment beneficiaries. We will ask for formal approval of this Overview, adjusted as you feel appropriate, at your June meeting. Once these principles have been approved, we will work on more detailed sections of the Guidelines, per the outline below.

- I. Overview (attached)
- II. Financial assets
  - A. Asset mix, risk/return considerations, performance measurement
  - B. Spending policy - philosophy
- III. Land assets
  - A. Overview of ownership (asset mix)
  - B. Overall management goals, risk/return considerations, performance measurement, philosophy on under-performing assets
  - C. Management objectives for types of assets
    - 1. Timberland
    - 2. Residential
    - 3. Recreational
    - 4. Commercial
    - 5. Cropland
    - 6. Grazing
    - 7. Transition
  - D. Land Bank (including acquisition strategy)
- IV. Recommendations/next steps
- V. Appendix/Exhibits

# **State of Idaho**

## **Endowment Asset Management Guidelines**

### **I. Overview**

#### **A. Background**

Endowment assets of the State of Idaho consist of both land and funds. All endowment assets are held in trust by the State in nine endowment trusts. The State initially received grants of 3.65 million acres of land in trust from the federal government in the Idaho Admissions Bill and through other federal acts. Over time, properties were sold or exchanged, with proceeds from the sales and certain other income deposited in the endowment funds.

The state Constitution establishes the State Board of Land Commissioners (Land Board) as the trustee over the assets of the nine endowments. As trust manager, the Land Board is obligated to manage the assets of each trust with undivided loyalty to the beneficiaries of the trusts. The Idaho Department of Lands (IDL) serves as the manager of the non-financial assets of each trust on behalf of the Land Board while the Endowment Fund Investment Board (EFIB) formulates policy for, and governs the investment of, the financial assets.

#### **B. Mission**

All endowment assets of the State of Idaho must, per the state Constitution, be managed “in such manner as will secure the maximum long term financial return” to the trust beneficiaries. The assets will be managed to provide a perpetual stream of income to the beneficiaries by:

- Maximizing long-term financial return at a prudent level of risk,
- Protecting future generations’ purchasing power, and
- Providing a relatively stable and predictable payout

#### **C. Asset Management Philosophy**

To fulfill its fiduciary duties to each individual endowment, the State of Idaho will:

1. Manage the endowed land and financial assets as a whole trust on a total return basis.
2. Seek to optimize risk and return from both the endowments’ land and financial assets through diversification of holdings.
3. Ensure that significant land holdings will be maintained in perpetuity, since they can provide material diversification and inflation protection to an endowment’s portfolio.
4. Seek to reposition parcels to reduce risk, lower management costs and increase prospects for immediate and sustainable income, recognizing that much endowment land remains in the original scattered parcels obtained from the federal government.

5. Provide for the management expenses of each endowment from its own income.
6. Consider multiple or public use of endowment lands if such use does not impair financial returns.

#### **D. Performance Objectives**

1. Over time, real returns for each endowment (after inflation and net of management expenses), should equal or exceed 4% annually and perform at or above median compared to relevant peers.
2. Assets will be grouped into classifications of similar character to facilitate performance monitoring and analyses of portfolio diversification and risk. Each asset class will have a targeted rate of return and is expected to perform at or above median compared to relevant peers.
3. The return of land assets should compete favorably with the return of financial assets. Where determination of land value is problematic, performance will also be measured by discounting expected net cash flows.

#### **E. Protection of Principal**

1. Proceeds from the sale of endowment lands will never be distributed, but must be reinvested in land within five years or transferred to the Permanent endowment funds.
2. Proceeds from extracted mineral resources will never be distributed, but must be transferred to the Permanent endowment funds.
3. The principal of the Permanent endowment funds, adjusted for inflation, will never be distributed, to protect the future purchasing power of the beneficiaries.

#### **F. Distributions to Beneficiaries**

1. Renewable income from the land assets as well as cash income and capital gains above inflation from the Permanent funds will be deposited in the Earnings Reserve accounts.
2. The Earnings Reserve Funds should buffer fluctuations in revenues to provide stable and predictable payouts to the beneficiaries. If an endowment's Earnings Reserve ever falls to zero, distributions must stop.
3. Long-term spending policy and annual distributions are recommended by the EFIB and approved by the Land Board. The Legislature considers the approved distributions in setting annual appropriations for the beneficiaries. The Legislature also appropriates the operating budgets for the IDL and the EFIB from the Earnings Reserve accounts.